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In the Supreme Court of the United States

OCTOBER TERM, 1949

No. 560

M. E. TRAPP, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The findings of fact and conclusions of law of the District Court (R. 12-31) are reported at 73 F. Supp. 385 and at 79 F. Supp. 320. The opinion of the Court of Appeals (R. 259-267) is reported at 171 F. 2d 1.

JURISDICTION

The judgment of the Court of Appeals was entered September 14, 1949. (R. 266-267.) A petition for rehearing was denied November 2, 1949.

(R. 280.) The petition for certiorari was filed January 27, 1950. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

QUESTIONS PRESENTED

1. Whether a valid partnership for federal revenue purposes existed between taxpayer and his wife for the year 1940.

2. Whether the doctrines of *res judicata* and equitable estoppel are applicable to an agreed judgment entered pursuant to a compromise agreement and without litigation in a different taxable year and not predicated on either a stipulation of facts or on findings of fact.

3. Whether the lower courts erred in determining the allocation of income derived from oil leases in a community property state between a husband and wife residing in a non-community property state.

STATUTE INVOLVED

Internal Revenue Code:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from in-

terest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * *

(26 U.S.C. 1946 ed., Sec. 22.)

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

(26 U.S.C. 1946 ed., Sec. 181.)

SEC. 182. TAX OF PARTNERS.

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

* * *

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183 (b).

(26 U.S.C. 1946 ed., Sec. 182.)

SEC. 183. COMPUTATION OF PARTNERSHIP INCOME.

(a) *General Rule.*—The net income of the partnership shall be computed in the same manner and on the same basis as in the case of an individual, except as provided in subsections (b) and (c).

* * *

STATEMENT

The deficiency upon which this litigation is predicated was based in part upon a determination by the Commissioner that no valid partnership existed between taxpayer and his wife for federal revenue purposes. Prior to the marriage of the taxpayer and his wife, Lou Strang Trapp, in 1907, she had a small estate. For several years after the marriage the only bank account of the Trapps was in Mrs. Trapp's name. Sometime after 1927, taxpayer became successful in the oil leasing and production business. (R. 21-22.) The businesses of the taxpayer have been conducted by the taxpayer. Mrs. Trapp has never taken an active part in any of the businesses. In 1935, for the first time, taxpayer divided his income between himself and his wife and then only for his federal income tax return. Between that year and the year in question, 1940, he continued to make equal division of his income with his wife on income tax returns. (R. 22.) The Trapps never filed a partnership information tax return. During the years of their marriage there has never been a written agreement of partnership. Purchases were all made in Trapp's name, as a general rule, and neither Trapp nor his wife held out any of Trapp's ventures as partnership transactions. On the contrary, he operated and carried on all the business ventures as his own. The withdrawals by Mrs. Trapp were only for household expenses, clothes and other "housewife" expenditures. (R. 22.)

On these facts, the trial court concluded that taxpayer had failed to prove a substantial contribution by his wife and that the long course of conduct refuted an assumption of partnership. (R. 22-23.)

A part of the deficiency tax assessed against the taxpayer was based on disallowance of the equal division between husband and wife in the 1940 income tax return of the income from Texas oil properties as community income. (R. 23.) Prior to this litigation, in 1935, the taxpayer had returned the income from the Texas oil properties as community income of himself and his wife. The division was disallowed and a deficiency assessed. Administrative proceedings for refund were had and, upon refusal, suit was filed with the Board of Tax Appeals seeking allowance of the refund. Therein the taxpayer complained of the deficiency assessment because of the failure of the Commissioner to recognize the income from the Texas oil properties as community income under the Texas law. Though the title to the property was taken by Trapp in his name, he asserted that the consideration for such property consisted of personal services rendered by him in Texas in obtaining the properties and of funds belonging to himself and his wife. (R. 23-24.)

There was never a trial of the case. A stipulation was agreed upon stating the amount of a deficiency, which deficiency excluded any tax upon the one-half of the income from the Texas properties attributed to the income of Mrs. Trapp. Upon this stipula-

tion an order was entered May 15, 1940, which recited: "Ordered and Decided: *There* there (sic) is a deficiency in federal income tax for the year 1935 in the amount of $643.52." The order was *pro forma* and not on the merits. (R. 24.)

The so-called King, Crisp and Bob White leases were purchased by taxpayer in 1932 with cash and required the rendition of some services by taxpayer in Texas in obtaining the leases. To the extent of the services the property was recognized by the lower courts to be community property. (R. 25-26, 264-265.) To the extent of the cash paid for the leases, since they were purchased with the taxpayer's separate property, the leases were themselves treated as separate property. (R. 26-28.) Following these criteria, an allocation was made by the trial court (R. 26-28) and approved by the Court of Appeals. (R. 264-265.) As for the so-called Moseley, Milas and Fenn leases, held by taxpayer in partnership with one Blankenship, the trial court found that the money borrowed by Trapp and any cash Trapp may have had on hand which went into the leases was his separate property; and since the court failed to find that taxpayer rendered any services in Texas in connection with these leases, it held that all of the income derived therefrom was taxable to him. (R. 28.) As in the case of the other determinations of the trial court, this conclusion was approved by the Court of Appeals. (R. 265-266.)

ARGUMENT

1. The Court of Appeals correctly determined that the doctrines of estoppel by judgment and *res judicata* are inapplicable in the case of an agreed judgment on a different cause of action where that judgment merely sets forth the amount of the deficiency, pursuant to a compromise agreement reached without actual litigation, and where it is predicated on neither a stipulation of facts nor on findings of fact. The lower court's conclusion in this respect is in harmony with, and was in fact required by, decisions of this Court. *Commissioner* v. *Sunnen,* 333 U. S. 591; *New Orleans* v. *Citizens' Bank,* 167 U. S. 371; *Tait* v. *Western Md. R. Co.,* 289 U. S. 620. Other courts of appeals have come to the same conclusion in like circumstances. *Gillespie* v. *Commissioner,* 151 F. 2d 903 (C. A. 10th); *Henderson* v. *United States Radiator Corp.,* 78 F. 2d 674 (C. A. 10th); *Hartford-Empire Co.* v. *Commissioner,* 137 F. 2d 540 (C. A. 2d); *Blaffer* v. *Commissioner,* 134 F. 2d 389 (C. A. 5th). This Court pointed out in *Commissioner* v. *Sunnen, supra,* p. 598, that where, as here, a different cause of action is involved, the taxable years being different—

> the judgment in the prior action operates as an estoppel, not as to matters which might have been litigated and determined, but "only as to those matters in issue or points controverted, upon the determination of which the finding or verdict was rendered." *Cromwell* v. *County of Sac,* [94 U. S. 351,] 353.

Moreover, as the trial court observed (R. 25), entirely apart from the nature of the earlier judgment and the circumstances of its entry, the doctrine of estoppel would have no proper application here; for that judgment, based as it was upon the allocation of family income between husband and wife for federal revenue purposes, was prior to the controlling decisions of this Court in *Helvering* v. *Clifford,* 309 U. S. 331; *Helvering* v. *Horst,* 311 U. S. 112; *Commissioner* v. *Tower,* 327 U. S. 280; *Lusthaus* v. *Commissioner,* 327 U. S. 293; *Commissioner* v. *Sunnen, supra;* and *Commissioner* v. *Culbertson,* 337 U. S. 733. In the words of this Court in the *Sunnen* case, *supra* (p. 600):

> a judicial declaration intervening between the two proceedings may so change the legal atmosphere as to render the rule of collateral estoppel inapplicable.

The cases relied upon by the taxpayer are easily distinguishable and, in view of the thorough analysis of the problem by this Court in the *Sunnen* case, *supra,* require no discussion.

2. The appellate court's approval of the trial court's determination that taxpayer had failed to establish the existence of a "genuine" partnership for federal revenue purposes conforms with the decisions of this Court in *Commissioner* v. *Tower, supra; Lusthaus* v. *Commissioner, supra;* and *Commissioner* v. *Culbertson, supra.* The reasons asserted in this connection by the taxpayer for the

granting of his petition for certiorari are in large measure the same as those proposed in *Kohl* v. *Commissioner,* 170 F. 2d 531 (C. A. 8th), certiorari denied, 337 U. S. 956, rehearing denied 338 U. S. 839; *Fainblatt* v. *Commissioner,* 172 F. 2d 389 (C. A. 2d), certiorari denied, 337 U. S. 957, rehearing denied, 338 U. S. 841; *Moore* v. *Commissioner,* 170 F. 2d 191 (C. A. 4th), certiorari denied, 337 U. S. 956, motion to file petition for rehearing denied, 338 U. S. 841; and *Eisenberg* v. *Commissioner,* 174 F. 2d 827 (C. A. 3d), certiorari denied, January 9, 1950.

The District Court did not, as suggested (Br. 23-24), rely solely upon the presumptive correctness of the Commissioner's deficiency determination but rather based its conclusion on its findings of fact made after a careful review of the evidence. The trial court's findings of fact, which were in every case supported by the evidence, were, *inter alia,* that "the businesses of the taxpayer have been conducted by Trapp"; that "Mrs. Trapp has never taken an active part in any of the businesses"; that "purchases were all made in Trapp's name, as a general rule, and neither Trapp nor his wife held out any of Trapp's ventures as partnership transactions"; that "he operated and carried on all the business ventures as his own"; that "the Trapps never filed a partnership information tax return"; that "during the years of their marriage there has never been a written agreement of partnership";

that "the withdrawals by Mrs. Trapp were only for household expenses, clothes and other housewife expenditures"; that, despite the fact that the purported contributions from which taxpayer seeks to justify the partnership occurred approximately twenty-five years earlier, "in 1935, for the first time, taxpayer divided his income between himself and his wife and then only for his federal income tax return"; that "the long course of conduct * * * strongly refutes an assumption of partnership"; and that the taxpayer "failed to establish a substantial contribution by Mrs. Trapp." (R. 22-23.)

Moreover, it is not true that the undisputed evidence indicated a substantial contribution by Mrs. Trapp. (Br. 34.) On the contrary, the fund purportedly contributed by Mrs. Trapp to the alleged partnership "was invested in municipal bonds and profits from the business remained in municipal bonds" (R. 81); and the record fails to disclose that this fund ever found its way into the purported partnership. According to the testimony of the Government's agents, the taxpayer had himself indicated that any contribution by his wife to a common fund was negligible. (R. 185, 187, 189-190.) Most important is the fact that, although the purported contribution occurred in 1907, there was absolutely nothing in the taxpayer's records or in the conduct of Mr. and Mrs. Trapp to indicate the existence of a partnership until 1935 when they first divided their income and then only for income

tax return purposes. (R. 14-15, 106-117.) In short, there is nothing in this record to indicate that "the parties in good faith and acting with a business purpose intended to join together in the present conduct of the enterprise." *Commissioner* v. *Culbertson, supra,* p. 742.

3. The principles of law enunciated by the lower courts in connection with the allocation of income derived from the operation of oil and gas leases in Texas conformed to the applicable state law. The general rule is that marital rights in real property located in Texas are governed by the law of Texas regardless of the residence of the spouses. The Texas law is, however, that property purchased with the separate property of one spouse is itself separate property. *Hammonds* v. *Commissioner,* 106 F. 2d 420 (C. A. 10th); *Noble* v. *Commissioner,* 138 F. 2d 444 (C. A. 10th). Since the lower courts found that the so-called King, Crisp and Bob White leases were purchased with the taxpayer's separate property, the leases were themselves to be treated as his separate property to the extent of their cost.[1] To the extent of the value of the taxpayer's services rendered in connection with the acquisition and development of the property, the courts recognized the taxpayer's privilege of treating the income as

[1] Since both lower courts concluded that there was no such confusion and commingling of separate and community funds as to render the funds unidentifiable, it is unnecessary to consider what the consequences would be if the funds had been so commingled as to render it impossible to identify them with reasonable certainty. (R. 265.)

community income under Texas law. (R. 265.) *Hammonds* v. *Commissioner, supra.* *Noble* v. *Commissioner, supra.* Moreover, taxpayer has little cause for complaint in view of the fact that the services which served as the basis for a community income allocation were described by him in the most vague and uncertain terms (R. 123-140), and were purportedly rendered during a period when he was fully employed as a corporation executive (R. 164). As for the Moseley, Milas and Fenn leases, which were held in partnership by taxpayer and one Blankenship, since the District Court found that taxpayer and Blankenship "each contributed one-half of the purchase price" (R. 28) and since there was no finding that the taxpayer had rendered any services in connection with the acquisition of the leases, the lower courts properly concluded that none of the income derived therefrom was community income.

CONCLUSION

The determination of the lower court is correct and involves no conflict with any other decision. The case involves only the application of settled principles to its particular facts, and there is no occasion for further review. The petition for a writ of certiorari should be denied.

Respectfully submitted,

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